COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

Staff Report On Proposed Rules Governing Customer Minimum Stay Periods

CASE NO. PUE010296

Division of Energy Regulation
Division of Economics and Finance

June 26, 2001

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Introduction

By Order dated May 15, 2001, the State Corporation Commission (the "Commission") initiated the instant proceeding, pursuant to § 56-577 E of the Code of Virginia, to consider the establishment of rules regarding minimum stay periods for electricity retail customers returning to capped rate service or default service after procuring electricity supply service in the competitive market. Specifically, § 56-577 E of the Code of Virginia requires:

> By January 1, 2002, the Commission shall promulgate regulations establishing whether and, if so, for what minimum periods, customers who request service from an incumbent electric utility pursuant to subsection D of § 56-582 or a default service provider, after a period of receiving service from other suppliers of electric energy, shall be required to use such service from such incumbent electric utility or default service provider, as determined to be in the public interest by the Commission.

In its Order, the Commission directed the Staff to conduct an investigation, with input from a work group, and file proposed rules and a report supporting such proposed rules on or before June 26, 2001.

In response to the Commission's directive, the Staff conducted a work group meeting on June 5, 2001. The meeting was attended by representatives of the 22 organizations listed in Appendix B. The work group identified and analyzed issues pertinent to minimum stay provisions, including approaches employed in neighboring states.

This report presents and discusses the Staff's analysis and proposal regarding retail customer minimum stay periods. Since the provision and pricing mechanism of default service subsequent to the expiration or termination of capped rate service has not been established, the appropriateness of minimum stay periods relative to such service cannot be evaluated at the present time. Accordingly, the Staff's discussion and proposal is limited in applicability to the local distribution company (LDC) provision of capped rate service, including default service under capped rates.

Minimum Stay Issues

The circumstances giving rise to a potential need for minimum stay periods relate to two factors. First, different pricing mechanisms exist for regulated, or capped rate, electricity supply service and competitive electricity supply service. Regulated rates are based on yearly or seasonal average embedded costs and provide a significant degree of rate stability for all months of the year or season. Competitive prices reflect actual or an anticipated series of short-run volatile marginal costs as determined by supply and demand conditions in the wholesale market, with high wholesale prices during high demand periods and lower prices during low demand periods. Secondly, the LDC has a statutory obligation to make electric service available at capped rates upon the request of any retail customer within its service territory.

In combination, these two factors create the economic incentives for astute retail customers to seek, as well as competitive service providers (CSP) to offer, electricity supply service from the competitive market during low demand periods when prices in the wholesale market are below the LDC's capped rate service, and for such customers to return to capped rate service for periods when market demand is high and wholesale prices are expected to exceed such capped rates. It should be noted that seasonal rates and the deliberate design of the stranded cost wires charge, if any, may mitigate some divergence in regulated and competitive prices, but probably not in full. Price-induced switching between the competitive and regulated markets is economically rational and, if allowed, should be expected; however, customers that return to capped rate service during high cost periods, paying only average cost, impose additional economic cost on the LDC through higher fuel or power supply costs and/or reduced competitive or regulated sales margins. Such costs may or may not be recoverable from and affect other customers receiving capped rate service depending on the LDC's approved mechanism for recovering fuel and power supply cost.

To avoid this potential negative financial impact on either the LDC or other capped rate customers, the LDCs generally argue for a 12-month minimum stay period for all customers returning to capped rate service from the competitive market. Such a requirement would provide for a more equitable matching of revenues collected from returning customers with the cost they impose. The LDCs insist it is simply unfair to allow customers to benefit from this inconsistency between regulated and market prices while imposing additional costs on other customers or the LDC.

On the other hand, Virginia is just beginning to implement retail choice. Advancing the development of a competitive market is a critical goal. Competitive service providers and large industrial customers generally oppose the establishment of a minimum stay period and indicate that establishing such requirements will limit competitive activity at a time the Commission should be attempting to stimulate it. They argue that denying a customer the opportunity to participate in the competitive market for 12 months after a return to capped rate service will harm efforts to encourage competition. Further, in the early stages of implementation, it is unknown whether a customer will have any further competitive options from which to choose should the current CSP terminate service.

Minimum Stay Periods in Other States

Review of minimum stay periods in other states implementing retail access indicates a range from no minimum stay requirement at all to a one-year minimum stay period, with some accompanied by a market-based pricing option as an alternative to the specified minimum stay period. As a general rule, the above minimum stay requirements apply to non-residential customers, at least initially.

- Pennsylvania: Although varying among utilities, non-residential customers may remain for one year or pay, either a demand minimum or the difference between the capped rate and the market price of supply for the months in which the incumbent provides service.
- New Jersey: Non-residential customers returning to the incumbent supplier during the summer months are required to remain for one year and those returning during a non-summer month are permitted 30 days to choose another supplier before being obligated to remain for one year.
- Delaware: Customers with a demand of 300 kW or greater who switch back to the incumbent supplier must remain for 12 months at tariff rates or receive service at monthly energy charges based on PJM market-based prices.
- Maryland: Minimum stay periods vary 6 to 12 months among incumbent utilities but only apply to commercial and industrial customers, with some utilities offering a market-based pricing alternative to receive service for less than the minimum stay period.
- Ohio: Although varying among utilities, non-residential customers returning to the incumbent supplier during the summer months are required to remain for one

year and those returning during a non-summer month are permitted 30 days to choose another supplier before being obligated to remain for one year. Some utilities offer a market-based pricing alternative to those customers choosing to continue shopping for a competitive service provider. There are provisions to revisit in 2002, a year following implementation of retail access, and possibly impose requirements for residential customers.

- Texas: The PUC declined to adopt minimum stay periods opting to structure the shopping credit to reflect changes in the market price of fuel and purchased energy.
- Massachusetts: Customers returning to the incumbent supplier are subject to a market adjusted pricing structure instead of fixed rates.

Staff Analysis and Recommendations

The Staff believes that concerns regarding the financial impact of the short-term return of customers to capped rate service during high cost periods must be balanced against efforts to advance the development of a competitive market and to encourage customers to exercise their right to choose a CSP. Both concerns are valid. While the Staff believes the adoption of a simple 12-month minimum stay period is appropriate for large customers, whose return to capped rate service pose significant financial risks to the LDC or other customers, it is a more difficult judgement as to where to draw the line in defining such customers, especially prior to any actual market development. As noted previously, several minimum stay periods in neighboring restructuring states are applicable to non-residential customers and have been developed in response to experience within those states. One option for the Commission is to follow this lead;

however, such a definition would include scores of very small customers. The Staff is hesitant to propose such broad applicability and restrictions on competitive activity at the start of retail access in Virginia. The Staff believes it would be preferable to start with a less restrictive minimum stay periods, in terms of customer applicability, and to closely monitor market development to ascertain what adjustments may be needed or desirable, based on actual experience. While extremely subjective, initially the Staff proposes consideration of a customer applicability threshold ranging between 200 kW and 500 kW of demand. For purposes of the Staff proposed minimum stay periods, included as Appendix A, the Staff has employed a 300 kW annual peak demand threshold, consistent with the Staff's understanding of the applicability of similar provisions in Delaware.

The Staff further proposes that the minimum stay issue be re-evaluated in late 2002 to consider the experience gained during the 2002 summer peak demand period. Additionally, it should be noted that several workgroup participants appeared receptive to considering a market-based pricing option for a customer's short-term return to capped rate service that would allow a customer to avoid a required minimum stay period. There are several fundamental and administrative complexities to the provision of such an option; however, the Staff believes that such market-based options hold promise in that they provide customers with additional flexibility. Further consideration of these market-based pricing options should be included with the proposed evaluation of minimum stay issues in 2002.

The Staff recommends that this proposed rule be adopted and effective for the full or phased-in implementation of retail access to electricity supply service. The Staff also recommends that this proposed rule amend the recently approved Rules Governing Retail

Access To Competitive Energy Services by adding a term to the Definitions in 20 VAC 5-312-10 and a rule to the Enrollment and Switching provisions as 20 VAC 5-312-80 Q.

APPENDIX A

PROPOSED RULES GOVERNING CUSTOMER MINIMUM STAY PERIODS

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Applicability; Definitions
20 VAC 5-312-10

"Minimum stay period" means the minimum period of time a customer who requests electricity supply service from the local distribution company, pursuant to § 56-582 D of the Code of Virginia, after a period of receiving electricity supply service from a competitive service provider, is required to use such service from the local distribution company.

Enrollment and Switching
20 VAC 5-312-80

Q. The local distribution company may require a 12-month minimum stay period for electricity customers with an annual peak demand of 300 kW or greater. Such customers that return to capped rate service provided by the local distribution company as a result of a competitive service provider's abandonment of service in the Commonwealth may choose another competitive service provider at any time without the requirement to remain for the minimum stay period of 12 months.

APPENDIX B

ORGANIZATIONS REPRESENTED ON THE STAFF WORK GROUP

Organization Name

American Electric Power
AEP Retail
AES-New Energy
Allegheny Energy
Allegheny Power
Columbia Gas of Virginia, Inc.
Christian & Barton, LLP
Conectiv
Dominion Retail
Dominion Virginia Power
e-SBiz
LeClair Ryan
Mecklenburg Electric Cooperative
Northern Virginia Electric Cooperative
Old Dominion Electric Cooperative
Rappahannock Electric Cooperative
Shenandoah Valley Electric Cooperative
The New Power Company
Virginia Department of Social Services
Virginia, Maryland, & Delaware Association of Cooperatives
Washington Gas Light
Williams Mullen Christian Dobbins